

### HISTORIC AUSTRALIAN MONETARY POLICY ACTIONS CREATES HEADACHE FOR CASH INVESTORS

The Melbourne Cup was not the only race that stopped the nation on November 3, 2020. The RBA has also opened the gates and sent investors on the track towards zero cash rates and short-term government bond yields.

In this short paper, we canvass the new monetary policies, their impact for cash investors before identifying potential liquidity and defensive opportunities open to investors looking down the track of an even lower for longer rates market.

#### What was announced?

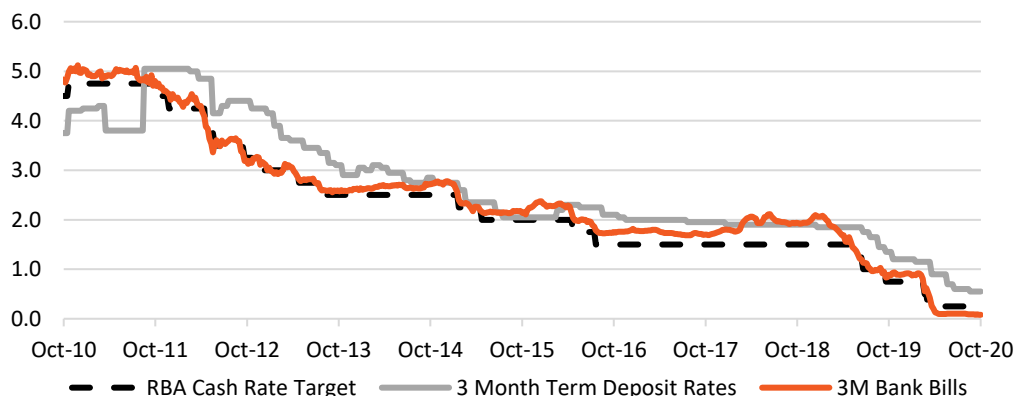
The RBA signalled a reduction in the following:

- cash rate target to 0.10 per cent
- target for the yield on the 3-year Australian Government bond to around 0.10 per cent
- interest rate on new drawings under the Term Funding Facility (TFF) to 0.10 per cent
- interest rate on Exchange Settlement (ES) balances to zero per cent

The RBA also announced the purchase of A\$100 billion of Government (Commonwealth and State/Territory) bonds with maturities of around 5 to 10 years over the next six months. Around A\$5 billion will be purchased in the secondary market through regular weekly auctions. Governor Philip Lowe added the RBA Board will “keep the size of the bond purchase program under review” and “is prepared to do more if necessary”.\*

While Governor Lowe has no appetite for cash rates to go into negative territory, technical pressures in money markets are likely to see yields trade negative in the months, and perhaps years ahead. The forward guidance from the RBA – now tied to actual inflation getting sustainably back into the 2-3% target band range – shows an intention to hold the policy rate low (near zero) for at least three years.

#### RBA cash rate target at 0.10% pushing cash markets towards negative



- RBA cuts in cash rates have lowered all money market yields
- Significant cash balances at banks have pushed bank bill yields well below the official cash rate
- RBA cash rates close to zero likely for 2021 and well beyond

Source: QIC, RBA as at 3 November 2020

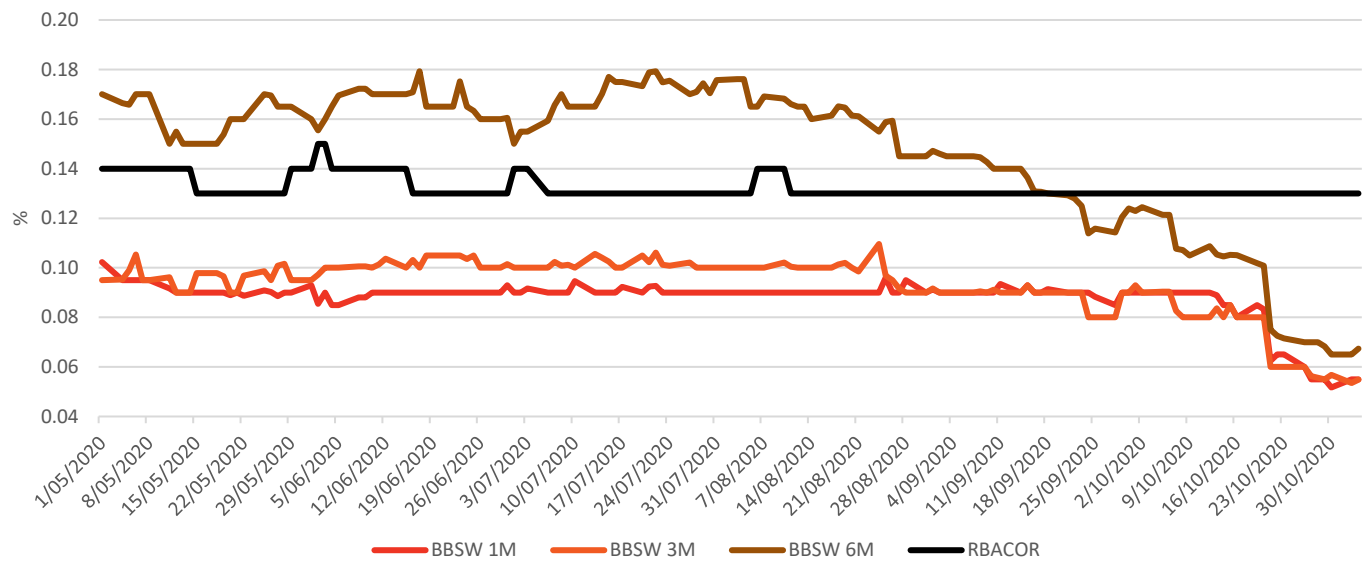
#### The markets' reaction

While the RBA's raft of policy announcements yesterday were largely expected, the decision to set the rate on Exchange Settlement Account (ESA) balances at zero per cent surprised the market which expected the rate would be set at five basis points to ensure short term private rates remained positive. A zero ESA rate means the decision to offer a positive deposit rate will be now more difficult.

*Exchange Settlement Accounts (ESA) are the means by which providers of payments services settle obligations that have accrued in the clearing process. (Source: RBA)*

Although the RBA continues to view a negative target cash rate as extraordinarily unlikely, the implications of the cut to the ES interest rate would most likely see the effective cash rate trading below 0.05% and for the Bank Bill Swap Rate (BBSW) to print negative at some point. It is important to note 3-month BBSW has set 3bps to 4bps below the effective overnight cash rate from May to mid-September.

\*Source: Bloomberg

**Bank Bill Swap Rates (BBSW)**

Source: ASX, Bloomberg

Banks will place money into their ES accounts to meet payment obligations with other banks and must at all times be in credit. The RBA will agree in advance with each account holder cash buffers that are required to meet intraday payments or other payments with the RBA paying the target cash rate. Any surplus money that is not used for this purpose was paid at a lower rate of 0.1% by the RBA which provided some support for the three-month BBSW setting between 0.09% and 0.11% from May to September. With the rate now at 0%, this could mean 3 month BBSW sets just above zero and may over time drift into negative territory. Having said this, there are other factors at times that will influence yields – such as a liquidity squeeze caused by market events, that would see yields rise, or if the market thinks the RBA will cut again, yields would fall.

**Impact on investors: The Positive Income Challenge in a Near Zero Cash Rate World**

Another consequence of record low yields is the increased frequency of daily negative returns. Since January, the Bloomberg AusBond Bank Bill index has recorded 27 days of negative returns; and with yields pushing lower again, we believe this will increase in frequency.

The Bloomberg AusBond Bank Bill Index is effectively the return generated from short term money (cash) market securities and often a key allocation of capital for investors' liquidity and cash holdings. For those investors, it will be increasingly challenging to just preserve capital, after fees and administrative costs. Additionally, we believe while a cash portfolio can retain a strong liquid profile and enhance returns through small allocations to term deposits, it is unlikely to generate sufficient income.

This environment will encourage investors to think hard about how much liquidity they truly need and optimally position their idle balances towards higher income solutions. Clearly seeking yield in the current environment is not a risk-free exercise; but there is a 'twilight' that has been illuminated in our view.

Our perspective reflects the desired transmission mechanism of the policies (of yield curve control and bond purchase) by the RBA and major global Central Banks to achieve the following:

- lowering interest rates to lower financing costs for borrowers;
- lowering exchange rates; and
- supporting balance sheets and asset prices.

In turn, these policies are supportive of non-Government credit markets and it is the shorter-dated credit market where we are continuing to see positive income opportunities. We believe rewarding income opportunities continue to exist in lending to quality, stalwart and investment grade Australian financial and corporate issuers.

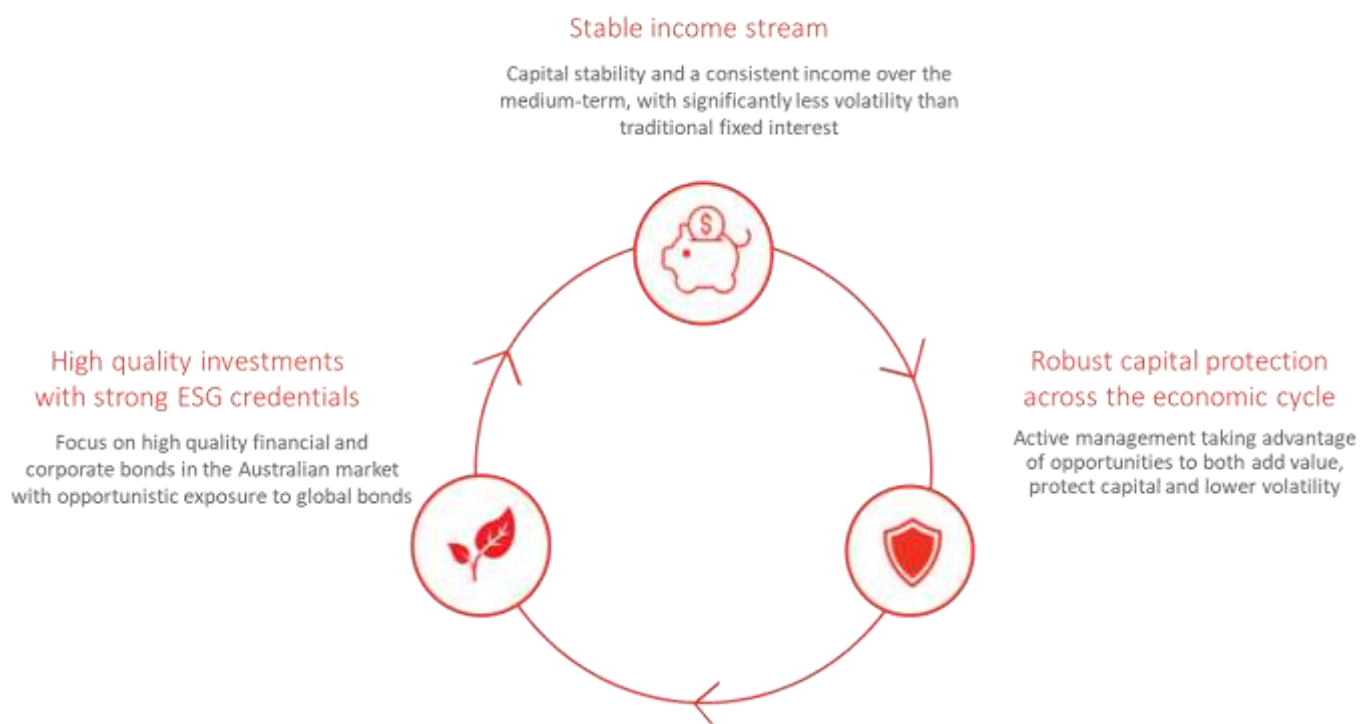
For idle cash balances, seeking more yield from a broader range of high quality financial and corporate issuers makes sense given the extended policy friendly environment, while continuing to undertake appropriate due diligence on underlying borrowers to ensure they will successfully ride out the impacts and ongoing uncertainties of COVID19 (until there is an effective vaccine available to mass populations).

### An investor checklist

To navigate through the challenges of a near-zero cash rate environment, we believe investors need to focus on:

1. Optimising cash allocations for liquidity, defensiveness and income
2. An approach based on an overriding focus on capital preservation
3. The incorporation of ESG considerations with each underlying investment to ensure portfolio resilience
4. To partner with global experts who are also the local leaders able to interpret monetary and fiscal policies and their market and investment implications.

With these elements, investors may win the race against the lower for longer rates market.



## IMPORTANT INFORMATION

QIC Limited ACN 130 539 123 ("QIC") is a wholesale funds manager and its products and services are not directly available to, and this document may not be provided to any, retail clients. QIC is a company government owned corporation constituted under the Queensland Investment Corporation Act 1991 (QLD). QIC is regulated by State Government legislation pertaining to government owned corporations in addition to the Corporations Act 2001 (Cth) ("Corporations Act"). QIC does not hold an Australian financial services ("AFS") licence and certain provisions (including the financial product disclosure provisions) of the Corporations Act do not apply to QIC. QIC Private Capital Pty Ltd ("QPC"), a wholly owned subsidiary of QIC, has been issued with an AFS licence and certain other wholly owned subsidiaries of QIC are authorised representatives of QPC. QIC's subsidiaries are required to comply with the Corporations Act. QIC also has wholly owned subsidiaries authorised, registered or licensed by the United Kingdom Financial Conduct Authority ("FCA"), the United States Securities and Exchange Commission ("SEC") and the Korean Financial Services Commission. For more information about QIC, our approach, clients and regulatory framework, please refer to our website [www.qic.com](http://www.qic.com) or contact us directly.

To the extent permitted by law, QIC, its subsidiaries, associated entities, their directors, officers, employees and representatives (the "QIC Parties") disclaim all responsibility and liability for any loss or damage of any nature whatsoever which may be suffered by any person directly or indirectly through relying on the information contained in this document (the "Information"), whether that loss or damage is caused by any fault or negligence of the QIC Parties or otherwise. This Information does not constitute financial product advice and you should seek advice before relying on it. In preparing this Information, no QIC Party has taken into account any investor's objectives, financial situations or needs. Investors should be aware that an investment in any financial product involves a degree of risk and no QIC Party, nor the State of Queensland guarantees the performance of any QIC fund or managed account, the repayment of capital or any particular amount of return. No investment with QIC is a deposit with or other liability of any QIC Party. This Information may be based on information and research published by others. No QIC Party has confirmed, and QIC does not warrant, the accuracy or completeness of such statements. Where the Information relates to a fund or services that have not yet been launched, all Information is preliminary information only and is subject to completion and/or amendment in any manner, which may be material, without notice.

It should not be relied upon by potential investors. The Information may include statements and estimates in relation to future matters, many of which will be based on subjective judgements or proprietary internal modelling. No representation is made that such statements or estimates will prove correct. The reader should be aware that such Information is predictive in character and may be affected by inaccurate assumptions and/or by known or unknown risks and uncertainties. Forecast results may differ materially from results or returns ultimately achieved. **Past performance is not a reliable indicator of future performance.**

This Information is being given solely for general information purposes. It does not constitute, and should not be construed as, an offer to sell, or solicitation of an offer to buy, securities or any other investment, investment management or advisory services, including in any jurisdiction where such offer or solicitation would be illegal. This Information does not constitute an information memorandum, prospectus, offer document or similar document in respect of securities or any other investment proposal. This Information is private and confidential and it has not been deposited with, or reviewed or authorised by any regulatory authority in, and no action has been or will be taken that would allow an offering of securities in, any jurisdiction. Neither this Information nor any presentation in connection with it will form the basis of any contract or any obligation of any kind whatsoever. No such contract or obligation will be formed until all relevant parties execute a written contract. QIC is not making any representation with respect to the eligibility of any recipients of this Information to acquire securities or any other investment under the laws of any jurisdiction. Neither this Information nor any advertisement or other offering material may be distributed or published in any jurisdiction, except under circumstances that will result in compliance with any applicable laws and regulations.

Investors or prospective investors should consult their own independent legal adviser and financial, accounting, regulatory and tax advisors regarding this Information and any decision to proceed with any investment or purchase contemplated by the Information.

Copyright QIC Limited, Australia. All rights are reserved. Do not copy, disseminate or use, except in accordance with the prior written consent of QIC.